

INTRODUCTION

This Section provides guidance on summarizing and effectively communicating conclusions to institution management and the board of directors. You develop conclusions from analyzing an institution's overall condition and viability through on-site examinations and other on-site and off-site regulatory reviews.

This section, written primarily from an examination perspective, refers to responsibilities of the examiner in charge (EIC). However, traditional titles, roles, and responsibilities vary among regional offices. Review your region's office structure and policy to determine where responsibility rests. Sometimes staff shares responsibility. For purposes of this section, we refer to "you" as the EIC and assistant examiners.

A primary goal of the regulatory process is to ensure savings associations operate in a safe and sound manner. For examinations and supervisory analyses to be most effective, you should identify the cause of any significant negative trends or problems and recommend a solution. A comprehensive yet concise analysis and summary of the institution's condition produce a more effective examination and allow directors and regulators to act promptly.

Your performance in this area is critical. You must be able to formulate conclusions and prioritize findings. Your ability to communicate findings to directors, management, and Office of Thrift Supervision (OTS) personnel significantly affects the regulatory process. Your findings help determine future strategies in the institution's regulatory profile and help directors correct weaknesses and capitalize on strengths.

This Section provides guidance in the following areas:

- Writing report comments.
- Developing conclusions and preparing comments.

- Formulating conclusions regarding the present condition and future prospects for the institution and for determining the institution's composite rating.
- Assigning CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk) ratings and an overall composite rating.
- Preparing a well developed, concisely written report of examination in plain language.
- Meetings with and presentations to institution representatives.
- Documenting off-site composite rating changes.

Report Comments

Examination reports should present a concise and balanced portrayal of an institution's condition and future prospects. Generally, report comments should include a synopsis of the work performed (scope) and your findings based on that scope. Your report conclusions should give the reader a clear understanding of the area reviewed.

A report of examination is factual and does not exclusively present negative or positive findings. It informs its readers, be they regulators, managers, or directors, of an institution's present condition and recommends a course of action to maintain or regain safe and sound operations.

You should identify strengths and weaknesses when necessary to provide a clear picture of the institution's prospects, or lack thereof, for future viability. Persons responsible for regulating institutions will need to have a balanced picture of its strengths and weaknesses.

Developing Conclusions and Comments

There are unique factors to consider when developing conclusions, comments, and ratings for

each CAMELS component. Each comment should be complete and concise. Discuss each component's material strengths and weaknesses by identifying patterns and trends. Support your conclusions with appropriate analysis, including underlying deficiencies. State management's proposed corrective actions.

The following checklist will assist in developing report comments.

- Present the scope of the review.
- Clearly state your conclusions about risk, condition, and the effectiveness of management practices.
- Clearly identify patterns and trends, and their causes.
- Present comments in a meaningful order, discussing major strengths and weaknesses, with proper emphasis and tone accorded to individual topics.
- Identify problems relating to safety and soundness and substantive compliance issues.
- Include the deficient underlying practices when you note patterns of regulatory noncompliance.
- Support conclusions with appropriate analysis and prepare an effective summary that does not lose the reader in detail.
- Assess the effect of examination findings on future operations.
- Include a discussion of corrective action where necessary.
- Support the comments with work papers and other retained documents.
- Disclose the component rating.

Formulating Overall Conclusions

The development of substantive overall conclusions involves:

- Reviewing major findings from the examination (including trends).

- Considering the institution's operating environment (both internal and external factors).
- Converting ultimate determinations into ratings.
- Communicating results effectively.
- Facilitating the corrective action process.

There are both objective and subjective factors involved in a comprehensive analysis of the institution's present and expected future condition. You must weigh the significance of criticisms, deficiencies, and exceptions to offset strengths. This requires reviewing CAMELS comments and other findings for interrelationships. Whenever a practice or other factor materially affects safety and soundness, you must look at both the present and potential future effects.

Consider the following when evaluating the institution's present condition:

- Examiners' findings, including CAMELS comments and ratings, trends, patterns, exceptions, and other observations.
- Patterns of regulatory noncompliance, deficient procedures, and other factors causing noncompliance.
- Interrelationships between findings noted for each CAMELS component.
- Effectiveness of the corrective actions initiated to resolve earlier deficiencies.

Evaluate an institution's future condition by making an assessment of the following areas:

- Adequacy of policies and procedures, personnel, information systems, books and records, accounting and other internal controls, audit function, and asset review function.
- Overall compliance with laws, regulations, and policies.
- The board of directors' and management's ability to take prompt corrective actions.

- Strategic planning and the written business plan, including changes expected in asset and liability composition, organizational structure, growth, etc.
- Management's ability to perform according to the business plan.
- Competitive, economic, and regulatory conditions. Include: management's ability to assess market conditions, trends, composition, and expected changes in economic conditions, competitive factors, and the regulatory environment.

One goal of the regulatory process is to prevent problems from developing or escalating in the future. Therefore, early identification of risk or weaknesses in management practices is key. Support any projections with adequate facts and analyses.

When developing a conclusion about the institution's future prospects, consider existing systems, policies, and procedures; the business plan; corrective action; projections for operating performance; management ability; market and economic factors.

Assigning Component and Composite Ratings

OTS uses a standardized system for rating savings associations it supervises. OTS rates thrifts according to the individual CAMELS components of Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. Based on a quantitative and qualitative review of these components, OTS assigns an overall composite rating.

After formulating the conclusions, you can begin the rating process. Since it is difficult to provide a specific formula for this process, experience and judgment are critical. It is inappropriate to simply average the individual CAMELS ratings or use standard formulas. A high degree of correlation should exist between the composite rating and the component ratings. The composite rating should support objective information in the Examination Conclusions and Comments page, the CAMELS comments, and the work papers.

You should refer to Thrift Activities Regulatory Handbook Section 071, CAMELS Ratings, for a discussion of the composite and component rating criteria and disclosure to thrift directors.

OTS personnel use the ratings for a variety of purposes:

- To reflect trends for a particular institution.
- To make comparisons with peers.
- To assess the condition of the industry.

The CAMELS ratings help determine appropriate strategies including the following:

- Frequency and scope of off-site and on-site analysis.
- Enforcement actions.
- Meetings with institution representatives.
- Analyzing applications (i.e., mergers and acquisitions and subordinated debt issuance).

Because ratings determine a variety of critical decisions, a systematic and logical analysis is essential. While objective analysis and findings primarily determine ratings, there is some reliance on subjective factors, too.

REPORTING RESULTS

Regional offices use the following three vehicles to communicate findings to institution directors:

- The Report of Examination.
- Meetings with institution representatives.
- The supervisory letter (for off-site changes in the composite rating).

Report of Examination (ROE)

Refer to the Report of Examination (ROE) Instructions and the Thrift Activities Regulatory Handbook to prepare safety and soundness examination reports.

Examination Conclusions and Comments

The Examination Conclusions and Comments page of the ROE should be the focal point for reporting conclusions from any examination or review. To facilitate timely corrective action, direct report comments to the institution's board of directors even though the document remains OTS property. Complete the Examination Conclusions and Comments page according to the ROE instructions.

Consider the following primary factors when developing this page:

- Report items that are material and that relate to safety and soundness.
- Present information that provides the reader with a clear understanding of the overall condition, adequacy of management practices, causes of major problems, and recommendations for remedial action.
- For regulatory violations, include only material patterns of noncompliance, along with the identified root(s) of the problems(s). A simple listing of violations is usually ineffective as a regulatory measure, particularly in the case of an isolated incident or error. While it is appropriate, in certain situations, to include isolated violations in the report, you should not bring them forward to the Examination Conclusions and Comments page unless they are significant.
- State conclusions and comments briefly. Do not repeat analysis or support provided elsewhere in the report.
- Demonstrate how items interrelate. Do not simply list them.
- Document all conclusions in report comments, work papers, or other records.

Present conclusions in an order that first describes matters requiring immediate follow-up supervisory action. The severity of a problem will dictate its order of presentation. Concisely state how the problem affects the institution's other activities and any mitigating circumstances.

Address the following items on the Examination Conclusions and Comments page:

- The type of examination and whether there was a holding company examination. If applicable, state that there is a separate holding company report.
- The asset size of the institution, principal lines of business, and the date of the financial statements in the ROE.
- A statement of the scope of the examination or supervisory review.
- A concise statement of your conclusions about the overall condition of the institution.
- A brief discussion of the CAMELS components (if applicable) and positive and negative attributes of other significant items reviewed. Focus on patterns, trends, causes of problems, and projections for future operations.
- Identification of "troubled" condition, if applicable.
- Disclose the composite CAMELS rating if assigned, refer to the definition of the assigned rating, and explain the correlation between the institution's circumstances and the rating.
- A statement regarding the extent of compliance with any outstanding enforcement actions or mandatory PCA restrictions, if any.
- A reference to necessary corrective action(s) as described on the Matters Requiring Board Attention page.

If necessary, you may use the ROE cover page letter to expand on examination findings. Do not merely restate examination findings in the ROE cover page letter.

Plain Language

You should write the ROE in plain language using the following principles:

- Simple everyday words except for necessary technical terms.

- Short sentences that are direct and to the point, with phrases in the active voice.
- Identifying the “doer.” For example, in this Handbook we use “you” to identify the examiner.
- Parallel ideas expressed in parallel constructions.
- Indented lists like this one, preceded by bullets or numbers.
- Descriptive headings that provide focus to subjects and break up long pages of text into manageable segments.

You may also refer to the OTS Style Guide available on the OTS Intranet under Tools.

Meetings with Institution Representatives

Meeting with institution representatives regularly during the examination will allow you to do the following:

- Introduce examiners to institution staff responsible for providing additional information.
- Discuss the scope of the examination at the start of the examination.
- Discuss preliminary findings and whether there is a need to expand the scope.
- Discuss results of the institution’s internal asset reviews, its asset classifications, and any differences between the regulator’s asset classifications and those of the institution.

After the on-site examination, meet with the institution’s senior management for a post examination discussion concerning your conclusions and recommendations. Normally you would meet after preparing the preliminary draft examination report. The EIC and CEO determine the appropriate date and time. The EIC is responsible for notifying any other regulatory personal who should attend. You should prepare an agenda for the attendees, and any exhibits that will strengthen or clarify the presentation.

The purpose of the meeting is to discuss examination findings, elicit management’s response to corrective action, verify conclusions, and answer management’s questions. This meeting gives you an opportunity to discuss strengths and weaknesses noted and recommend corrective action if necessary.

Regulatory personnel should meet with the institution’s board of directors when deficiencies are serious. When discussing the need for corrective action, be specific and agree on a time frame. Refer to Thrift Activities Regulatory Handbook Section 320, Meetings with the Board of Directors, for additional guidance. Although it is not necessary to meet with the board of directors after each examination at institutions with no serious deficiencies noted, we encourage regulatory personnel to meet periodically with the board after selected examinations to maintain an open line of communication.

Disclosing Ratings

You will disclose component ratings and composite CAMELS ratings at exit conferences with senior management and, when appropriate, the board of directors. Obtain sufficient concurrence from regional management, so that the ratings you disclose are final, or subject to revisions only in rare instances. If the ratings are subject to further review, let thrift management know that the ratings are not final.

We expect you to discuss the elements considered in assigning each component rating and those considered in assigning the overall rating. You should indicate that a careful evaluation of the institution’s managerial, operational and financial performance and their compliance with laws and regulations determines the composite rating.

Supervisory Letter

When the regional office changes the composite ratings off-site, send a supervisory letter to the board of directors to notify them of the change. A change in the composite rating may result from changes in the institution’s operating strategies or conditions. An on-site review may be appropriate when conditions warrant a downgrade in rating. When the composite rating changes, we advise

evaluating the need to change all six CAMELS component ratings. Include in the supervisory letter a prohibition against outside disclosure and explain why the rating changed.

REFERENCE**Office of Thrift Supervision**

OTS Thrift Safety and Soundness Report of Examination Instructions